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INCOME TAX ENFORCEMENT IN SPAIN

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1. INTRODUCTION

The purpose of this paper is to provide a description of the system of income tax administration in Spain, including its evolution since 1978. In some respects the Spanish **ITA** is extremely advanced, such as in its state of computerization, while in others it is not as developed as some other countries such as Mexico (with respect to manpower, auditing or prosecutions) or Peru (in the degree of autonomy of the tax administration).

Section 2 describes the background to the reforms. Section 3 discusses organizational changes, and Section 4 the information system. Sections 5 and 6 deal respectively with manpower policies and auditing, and Section 7 with appeals, penalties and prosecution. Finally, Section 8 provides a summary perspective, and directions of further changes that are necessary.

2. BACKGROUND

Following the death of General **Franco** in 1975, and the onset of democracy in the following years, a fiscal act was passed in 1978 by the new Parliament, introducing a new income and net wealth tax. Indeed, the introduction of the new Spanish Constitution was preceded by a set of urgent fiscal reform measures (including introduction of a **wealth** tax, and incorporation of tax crime into the penal code), reflecting the central importance assigned to fiscal reform in the new democratic process.

Prior to 1978, the income tax system was fragmented into four different taxes, defined by separate laws, and applied on different bases: earned income, dividends and interest, **self-**

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²**Indian** Statistical Institute, New Delhi.

employed and **entrepreneurial** income, and real estate income. It was based on self-assessments by the relevant taxpayers, with obligations to pay taxes through the year (in the form of withholding or advance tax) which were to be adjusted for payment obligation at the time of filing **annual** returns. The exemption limit was set at a fairly high level, with the effect that there were only about 400,000 taxpayers in 1977. **Income** tax revenues amounted to a small fraction of GDP (about 4% in 1978, as compared to 5% in France, 6.5% in Italy, and approximately 11% in the U.K., Germany and in OECD countries on average).

The sources of dissatisfaction with the **system** prevailing before 1978 were several. First? there was a general consensus that taxes would have to be increased substantially in order to finance the expenditures that were to accompany the democratic reforms (such as increased outlays on social security and health). Indeed, government transfer payments increased from about 4% of GDP in the years 1975-77 to over 5% in 1978-79, a factor largely responsible for the increase in total government expenditures from about 7.5% of GDP to over 8% during this period. At the same time, the budget deficit increased steadily, from near zero in **1975**, and less than 0.5% in 1977, to over 1.5% in 1978. Secondly, the existing system was perceived as inequitable, partly owing to the fragmented nature of the system, and partly to the preponderance of indirect taxes. The democratic process was associated with a demand for a fairer distribution of **social** welfare and wealth, for which a comprehensive, progressive income tax was considered essential. Third, the Spanish tax system was **very** different from those prevailing in the rest of Western Europe, and the need was felt for developing a system which would facilitate the growing internationalization and sophistication of the Spanish economy, as well as prepare for eventual integration into the European Community.

The fiscal reform introduced comprehensive income and net wealth tax laws, and the requirement of progressivity was written into the Constitution. The exemption limit was also lowered, leading to a sudden and large increase in the number of taxpayers from approximately **400,000** prior to the reforms, to over 6 million in 1981 (see Table 1).

At the same time, no reform of the 'tax administration was contemplated in 1978, implying a sharp increase in the workload of the **ITA**. For instance, the total employment remained stationary, at approximately 11,500 persons, during the period 1978-83. No substantive attempts were made either in the area of operating procedures, reorganization or introduction of information technology during this period. The difficulty of implementing the new tax laws led to a strong impetus to reform tax administration by **1983**.³ According to the Report on the Reform of Personal Income and Net Wealth Taxes of the ministry of the Economy and Finance, 1990:

“ **The** Government formed at the end of 1982 considered that the fight against tax fraud was the principal priority of the Tax Administration and it estimated that such a fight

³**This** was manifested for instance in the reference to the problem of tax fraud in most **political** programs presented for the 1982 general elections.

required an administrative reform which aimed at physically converging the administration and the taxpayer such that information flows travelled at the least possible cost.” (Chapter 9, p.159)

TABLE 1: NUMBER OF TAXPAYERS AND TAX AUDITORS

Year	Number of filing taxpayers (millions) (1)	Employment in ITA (2)	
		Inspectors	Subinspectors
1981	6.02		
1982	6.27		
1983	6.41		
1984	6.57	827	1511
1985	7.10	689	1659
1986	7.90	599	1544
1987	8.03	561	1715
1988	8.95	593	1796
1989	9.84	606	1776
1990	10.97	664	1812
1991		669	1809
1992	12.25	789	1822
Source: (1) Recadacion y Estadisticas de la Reforma Tributaria (1981-1992) , Director General de Tributos, Ministerio de Economia y Hacienda (2) Memoria de Actividades, 1992 , Agencia Tributaria, Departamento de Inspeccion Financiera y Tributaria .			

The need for administrative reform arose also from the perceived inequity of the system which allowed hard-to-tax groups to evade taxes systematically. In 1982, for instance, earned income came to represent 84% of personal income tax receipts, far in excess of its percentage in GDP. Six years later this was to come down to 69.5 %, following administrative reorganization measures. An additional reason for needed reforms in administration arose from the need to introduce VAT to facilitate Spain's entry into the European Community in 1985. However, this factor was of limited importance compared to the need to deal with the manpower crunch

problem mentioned above.

Consequently, in 1984 a process of transformation of **the** tax administration was initiated. This included the following changes: (i) reorganization of central and regional tax services; (ii) large scale computerization; (iii) increased employment of human resources; and (iv) increased autonomy- Particular emphasis was given to the computerization program. and some emphasis also to methods of decentralization and cost control within the tax administration. These are described in further detail below.

The -increase in manpower was **particularly** concentrated in the area of information technology, for which a separate Data Processing Corps was created. As is evident from Table 1 above. the large increase in the number of taxpayers filing returns since 1984 has not been paralleled by a corresponding increase in the number of tax inspectors or sub-inspectors (agents carrying out audits). Indeed, the **total employment** of the **ITA** currently stands at about 26,500, i.e., somewhat more than doubled since 1978, whilst the number of taxpayers has increased by a factor of almost twenty-four times. This suggests the important role played by the computerization process in handling the growth in the volume of workload. Indeed, the advanced state of computerization perhaps explains why the Spanish tax administration tends to employ proportionately less manpower than other developed countries (e.g., it employs 0.66 persons per 1000 population, as contrasted to 0.92 for the USA, 1.41 for Canada, 1.79 for France, and above 2 for the UK and West Germany). Moreover, it appears to be more cost effective as **well**.⁴

In **particular**, when compared to Mexico, there is a striking absence of emphasis on aspects of manpower allocation or motivation, and of active initiatives in the area of criminal proceedings against instances of tax fraud. In this respect the Spanish reforms in tax administration still have some way to go, and some of the directions in which further changes are necessary are **spelt** out in Section 8.

The revenue realizations from various taxes for the period 1970-90 are described in Table 2 below. It is evident that the share of direct taxes has grown substantially, both in relation to **GDP** (by about 8 percentage points), and in relation to other taxes. Indirect taxes have also grown, but at a relatively modest rate (by 2 percentage points). The share of capital taxes is low and has **remained** stable; the net result is that total revenues have **increased by** about ten percentage points of GDP. These data suggest that the tax reforms have been a remarkable success, though it is **debatable** the extent to **which the** increased revenues are the result of the changes in the tax laws, tax administration, or increases in GDP?

⁴For Agencia **Tributaria** statistics disclose **an** estimate of collection costs per 100 units of account of 0.90, compared to 0.83 for the USA, 1.18 for Canada, and 1.47 for the UK.

⁵**For instance**, M. Jimenez and R. Salas (1992) in a **working** paper of the Institute of **Fiscal** Studies, identify the increases in revenue in **terms** of the buoyancy of the tax with respect to

TABLE 2: REVENUES AS PERCENTAGE OF GDP, 1970-90

	Production and import taxes	Income and wealth taxes	Capital taxes	Total
1970	7.8	3.5	0.25	11.5
1971	7.5	3.7	0.25	11.5
1972	7.6	3.7	0.31	11.6
1973	7.9	3.9	0.27	12.0
1974	6.9	3.9	0.24	11.0
1975	6.6	4.3	0.24	11.2
1976	6.6	4.6	0.21	11.4
1977	6.6	4.8	0.20	11.6
1978	6.1	5.4	0.19	11.7
1979	6.2	6.0	0.18	12.3
1980	6.6	6.9	0.18	13.6
1981	7.2	7.1	0.20	14.6
1982	7.7	6.7	0.16	14.6
1983	8.5	7.8	0.15	16.4
1984	8.9	8.2	0.18	17.4
1985	9.5	8.5	0.21	18.2
1986	10.8	8.2	0.19	19.2
1987	10.8	10.3	0.20	21.3
1988	11.0	10.5	0.25	21.7
1989	10.9	12.1	0.23	23.2
1990	10.6	11.9	0.21	22.7
Source: National Accounting Records, National Statistics Institute.				

GDP changes, and the real increase in the tax base. But a further decomposition is not available.

Nevertheless, the 1990 Report on the Reform of Personal Income and Net Worth Taxes of the Finance Ministry expressed the view that the administrative changes had placed the Spanish tax administration on par with European and North American administrations. More specifically, "The emergence of over two million taxpayers within the IRPF and the increase in revenue raised, without modifying the tax policies, show that the primary deficiency of the 1978 reform was the incapacity of the Tax Administration to guarantee its adequate compliance."⁶

On the other hand, public opinion concerning the fiscal system is not terribly favourable. According to surveys carried out by the Sociological Research Center, 15% of those surveyed in 1986 felt that the tax system was fair, as against 14% in 1992. The proportion of those who believed it was not fair was 71% in 1986 and 75% in 1992. On the other hand, 64% believed that the tax administration was acting effectively in limiting tax fraud.⁷

3. ORGANIZATIONAL STRUCTURE

Prior to 1984, the tax administration consisted of a central office, and approximately 50 regional offices with executive functions (Tax Delegations). The system was therefore substantially decentralized, with the central office exercising little control or coordination across the regional offices. There was one Tax Delegation in each province, which meant that there was substantial distance between taxpayers and the nearest local office. The most substantive change was the creation of 204 local tax offices, which substantially reduced this distance.

Second, two new levels were created at the regional level, resulting in a total of three effective levels. At the very bottom level were the 200-odd local tax offices. Above these were the previous set of 56 provincial delegations. The provincial delegations in turn were now supervised by a set of special tax delegations, who were responsible for coordination with the central services of the Ministry.

Third, at the central level, a limited degree of autonomy was granted to the newly created position of the General Finance Secretary. The process of revenue collections was integrated into the administration by the creation of a Directorate General of Revenue Collection, and by a similar functional department in local offices as well. In 1987 a Directorate General for Tax Management was created. These reforms consolidated the functional structure of the organization. Moreover, the Directorate General for Audit was given a new structure, with audit teams (comprising one inspector and three or four subinspectors) defined as the basic unit for audit tasks, and creation of units specialized in international taxation, tax crime and investigation of special areas.

⁶See pp. 160-161 of the 1990 Report.

⁷See Lasheras and Menedez (1992).

In 1992, there was a move to provide additional autonomy to the tax administration, by creating the Agencia **Estatad** de Administration Tributaria (**AEAT**), for reasons to be **discussed** more fully below. The current organization chart of **AEAT** reveals a functional structure which is the norm in most countries. The Director General has under him three or four staff departments (Planning and Evaluation office, **Legal** Services, **Internal** Control; and External Control (which coordinates with private banks acting as collection centres, and exercises control over expenditures within **AEAT**)), and a number of Directorates dealing with different functions (Tax Assessment; Tax Audit and Inspection; **Information** Services; Tax **Collection**; Human Resources; Customs and Excise Collection; Economic-Financial Services, dealing with procurement among other functions). The Tax Assessment (Gestion Tributaria) Directorate provides general control of the audit process, and coordinates the conduct of audits at regional and local levels. The Audit and Inspection Directorate (**Inspeccion** Financiera y Tributaria) prepares the national plan of audit, has a central investigation unit, as well units for **special** categories- of taxpayers.⁸

Regional and **local** offices are also structured similarly, so that a functional department at the regional level is supervised directly by the corresponding department at the central level.

The Director General reports to the President of the **AEAT**, *who is normally the* Deputy Minister of Finance, and is also supervised by a Director's Council (Consejo de **Direccion**), whose members include the Budget Director, the Auditor General, and the Deputy Minister of Finance, besides the General Directors of the functional departments at the central level. This Council also advises the Finance Ministry on the formulation of tax policy, though the **AEAT** has no jurisdiction over this aspect.

It is worth noting that the tax administration integrates the collection of customs and excise with **that** of income taxes. This has *been* particularly facilitated by computerization.

The mode of operation is that of a classic vertical hierarchy, **with** information flowing up from local to regional and eventually to the central level, followed by the formulation of a yearly audit plan and the setting of targets for revenue collections which subsequently flow down to the regional and then to the field units. However, the new information network has expanded communication to horizontal as well as vertical lines, though operational procedures still appear to operate vertically.

Nevertheless, the system is **also** notable for creating a pattern of **decentralization** of responsibility to **local** levels. There are about 70 budgetary centers, coinciding with the **central**

⁸In this respect the system is similar to the Indian one, which divides investigation and assessment into separate departments. Not surprisingly, Spanish tax officials confessed that there were certain problems of coordination across these two departments, and this was an area which might witness some reforms in coming years.

departments and regional delegations of the Agency.' These contain within themselves about 300 cost centers, the exact set of which is defined flexibly in accordance with current needs. Following negotiation with the immediate superior, the official in charge of the budgetary center is assigned specific objectives, and a budget of his own with decision-making power over its execution, both of which are incorporated in a computerized center for follow-up and control. The center updates on a daily basis the progress made with respect to achievement of the set objectives, and this data can be consulted on-line by managers or superiors to review the performance achieved so far. The system guarantees a certain impersonality and objectivity to the performance evaluation system, and facilitates management control at the central level.

Also notable is the computerized accounting information system, the development of which (involving adaptation of standard software in enterprises of comparable size) took about one year to accomplish. This system integrates financial (balance sheets, profit and loss statements), budgetary (statements on budget execution) and analytical (breakdown of expenditures by cost centers and by activities) data. It lays down the methods for allocation of joint costs across different departments. Most important, it permits a detailed breakdown of expenditures by several methods of classification: (i) on what items are expenditures made ('economic'); (ii) which cost centers incur the expenditure ('organic'); and (iii) across different functional areas. The purpose is to allow management to estimate the cost of different activities.

While the Director General of tax administration has been granted degrees of autonomy by the successive reforms in 1984 and in 1992, it nevertheless appears to have a rather limited form of autonomy, especially when contrasted to Mexico or Peru. For instance, limited flexibility is allowed with respect to the size of the budget, the level of manpower, compensation policies, or the freedom to contract out services to the private sector (though there is a progressive trend towards greater autonomy in recent years). Budget and manpower sizes have to be proposed to the Ministry of Finance, as part of an overall plan across all government departments, and corresponding allocations are handed down by the Ministry. Nevertheless, it appears to have been successful with respect to its large scale computerization plan, including both purchase of hardware and software, and in the creation of a Data Processing Corps in 1990. However, its limited control over compensation policies have resulted in a large differential in salaries relative to the private sector for different skill groups, including data processing personnel and tax inspectors, with resulting high rates of attrition. Vacancies have traditionally taken an average of 18 months to fill, though this has improved in recent years. Likewise, services have been contracted out to the private sector to a limited degree (certain elementary office services such as cleaning⁹), and procurement

⁹See Hurtado de Mendoza (1993).

¹⁰Indeed, currently about 3096 of all employees of AEAT are non-civil-service employees, most of whom are employed in manual tasks.

procedures have become more flexible, but not as **flexible** as those in the private sector.”

The stated objectives of the granting of additional *autonomy* in the form of the **creation** of **AEAT** in 1992 were to: (i) increase control over the objectives of the organization, as well **as** concerning the setting of targets, **and** monitoring performance relative to these; (ii) allow **greater** flexibility over budgets; (iii) **create a legal service to provide support for the tax** administration in the courts; (iv) inculcate a new culture of providing service to taxpayers; and (v) **allow** adaptation to a new income and net wealth tax law introduced in 1991, as well as **customs operations to the creation of a single market in Europe. Nevertheless, it is clear that** the Spanish administration still has some way to go in the direction of further autonomy, particularly in the areas of personnel and budgetary policies.

4. INFORMATION SYSTEM

The most impressive development during the last ten years has been the establishment of a highly sophisticated system of information technology, one which compares with the most highly advanced systems in the world. **Before** describing **this** in detail, it is **necessary** to discuss the nature of withholding and third-party information available to the tax authorities.

All income **earners** above the exemption **limit (400,000 pesetas** annually for those filing individual returns since 1991) are required to file an income tax return. This applies **also to** those whose incomes consist entirely of earned incomes; so that all taxes are paid by **them** in the form of withholding. **This implies** a large number of registered taxpayers, many of whom do not owe additional taxes at the time of filing an annual return. The reason for this requirement is **that** the Spanish Constitution mandates a comprehensive, progressive income tax which incorporates family circumstances in adjusting tax liabilities.

Withholding applies to wages and salaries, dividends, interest, and professional fees. Taxpayers are **required** to report initiation or termination of their business or professional activities, as well as changes in domicile. All taxpayers have a taxpayer identification number (**NIF**), a system introduced in various stages. Since 1975, the **NIF** had been obligatory for **all** corporate bodies. A 1985 decree extended it to individual business or professional persons, and a subsequent 1990 decree extended it to **all** individuals. This number **simply** augments **the** number of the national identity card by a control character. This number is a prerequisite **for** all employment and business activity. In **1990**, a total of 27.5 million taxpayers had been issued this number (out of a total population of 38 million).

¹¹**For** instance, as disclosed by **Hurtado de Mendoza**, the new system has integrated the first two phases of procurement: authorization of expenditures and commitment to expenditures, but not the third, which is the actual payment following delivery. Traditional modes of public administration keep these three modes separate, while most private sector **enterprises integrate all three.**

Third party obligations are as follows: employers must supply information on wage payments and fees paid to professionals; any person or institution paying interest or dividends must supply information concerning the recipients. Tax authorities can also ask banks for information on taxpayer deposits. *Finally, the* authorities have general *control and search* powers: they can require taxpayers relevant documents and records. they have full and free access to taxpayer dwellings and business premises with the taxpayers consent (failing which a search warrant is required). No warrants are required for seizure of documents, and the tax authorities have the power to obtain information from other government departments.

Nevertheless, the tax administration did encounter opposition from banks with respect to reporting on certain kind of taxpayer transactions believed to be used as ways of **evading** taxes.¹² This arose owing to differing **legal** interpretations held by the tax administration and by financial institutions, but from 1986 onwards these were reported and used effectively in audit operations, with significant **results**.¹³

The computerization programme was initiated in the 70s itself, but it was not until 1983-84 that a decisive plan for comprehensive investment and reorganization of operations was **undertaken**, mainly in **order to relieve** the **massive** manpower crunch faced since the number of taxpayers increased to over six million.

The programme was undertaken *in* two phases roughly. ~~The~~ first phase which lasted from 1984 till 1987 involved the acquisition and installation of hardware, the development of regional and national data bases, of **local** data processing units, of a central taxpayer management programme, the introduction and computerization of the **value** added tax. and automation of company taxes as **well** as of personal income tax refunds. The national data base (BDN) project included the creation of a teleprocessing network throughout the country, any at the end of this phase in 1987, all tax offices were connected via leased lines to the BDN. The largest investments were undertaken during this first phase: the change in the configuration between 1983 and 1988 is shown in Table 3 below. The total cost of this investment amounted to about \$200 million, far larger than for many other countries investing in information technology in the **80s**.¹⁴

¹²**Prominent** among these are single premium insurance agreements. Problems **arose over** whether it was to be classified as an insurance product (taxed as capital gains) or as a financial product (taxed as returns on investment), since only financial products are subject to a withholding tax.

¹³**Lasheras and Menedez (1992)**, pp. 14-15.

¹⁴**For** instance, the Mexican investment during the period 1988-92 amounted to **\$17** million, in Portugal for the period **1980-90** amounted to \$10 million, and in Costa Rica and Chile for the same period amount to \$2.7 **and** 2.5 million respectively.

TABLE 3: DETAILED CONFIGURATION OF INFORMATION TECHNOLOGY
HARDWARE, 1983-88

	1983			1988		
	Central	Regional	Total	Central	Regional	Total
Computers	5	6	11	12	108	120
Memory (MB)	9	59	68	132	584	716
Processing (MIPS)	3	33	36	33	101	134
Disk storage (GB)	10	46	56	178	330	508
Printers	5	78	83	29	848	877
Terminal	27	636	663	339	3680	4019
Source: J.D. Santiago Martin, 'Computerization of the Spanish Tax Administration', CIAT Conference, Montevideo, February 1989.						

The second phase started in 1988, which involved **consolidation** of the systems installed already, and in the large scale use of data made available by the system. Between 1983 and 1991, **processing** speed rose from 36 MIPS to 291 MIPS, central memory from 67 MB to 2110 MB, and the number of terminals from 663 to **9600**.

The most important feature of the system established is that it combines the central management of data with decentralized computation of routine tasks. The tension inherent between these two functions 'experienced in countries like the USA and Germany which embarked on computerization in the 60s and the 70s, was largely overcome by the emergence of the new communication technology in the 80s involving the creation of large decentralized networks connected to central data processing networks. In this respect, the Spanish system has utilized its 'latecomer' advantage to leapfrog the earlier pioneers in a number of respects. The data network had nearly 370 point-to-point teleprocessing lines by 1991, making it possible for every tax office in the country to access central data banks: efforts are currently under way to utilize communication satellites to enhance the speed and accuracy of transmission.

The computerization programme did not cause any **radical** reorganization of the tax administration. By creating a separate data **processing** department, it allowed the functional structure of the remainder of the organization to be unaffected. Two additional advantages were claimed for this approach: the realization of economies of scale by centralizing data processing, and a certain element of transparency and 'constructive' tension by separating the producers from the consumers of information services.

Some of the important components of the information technology and its uses are the following:

(a) The National Data Base (BDN) which identifies taxpayers, consolidates information concerning each taxpayer, and is used to select taxpayers for audits. **Powerful** software has been developed to achieve precise identification of taxpayers, even where the **fiscal** identification number is unknown or where the number given is erroneous. Currently over 21 million potential taxpayers are registered, well in excess of the actual number of taxpayers, and therefore helpful in controlling **nonfilers** or stopfilers. The data base can be accessed from any terminal in any tax office in the country, utilizing the teleprocessing lines. information confidentiality is ensured by an **elaborate** security system, including both ex ante and ex post controls: the system records the terminal from which a query was made, the user's identification, and the information requested. Information cross-checks are carried out between tiled returns, transactional data, and third **party** information supplied. Particularly sophisticated is the CLASE application used for audit selection, as well as to self-evaluate the database in what is the first step towards the use of an expert system. It allows the identification of taxpayers according **to the** intersection of a number of different criteria such as tax information contained in the BDM, VAT returns, properties **owned** and purchased, business and professional activity, board members and executives of large business houses, and external signs of income and wealth (such as ownership of vehicles or **yachts**).¹⁵

(b) The **National Tax Management Programme (NPGT)**, **which** contains a tax register, a statement of accounts, payments and annual returns for each taxpayer, and also issues collection notices. The data vector for each taxpayer also **includes** a reliability indicator for each obligation **assigned** to the taxpayer.

(c) **SIRENA** and **GEMA** are two decentralized systems located in provincial centers used. for managing collections and customs respectively.

(d) **ONI** (Office of National **Inspeccion**) is devoted to monitoring of large taxpayers (comprising **4% of taxpayers but accounting for over 85% of collections**).

(e) **TEAR** is used by administrative tribunals involved in deciding taxpayer **appeals**, and is used **in** initiating cases, preparing the 'proceedings **file**', generating precedents from past decisions, and enforcing the decision made.

(f) **INFO** and **PANINFO** are **applications** used for planning and evaluation, making available **continuously** updated statistics on collections, audits etc, **classified** according to various criteria (e.g., by taxes, by region, by function). It enables revenue **projections to be made, as well as** establishing a system of monitoring progress made towards achievements of targets, and an

¹⁵**For** further details, see Santiago **Martin** (1990).

accounting information system elaborated further in the previous section.

(g) Services rendered to taxpayers are monitored by an application called EXPRESS, e.g., in the form of setting targets for taxpayer time consumed in complying with obligations. PADRE is a programme designed to help small taxpayers' complete their annual tax returns: over 1.3 million taxpayers were provided with this service in 1991, and **over** twenty **thousand** copies of the program diskette were distributed (mostly to tax consultants). **INFORMA** is an application used for replying to taxpayer queries.

(h) Office automation of interdepartmental mail (via an electronic **mail** network), appointment calendars, text processing, and tax and interest calculations.

The developments **currently** under way include the use of communication **satellites**, in order to transmit voice and images; the use of OCR technology to input the data contained in tax returns; and the reduction of the number of data recording centers from 260 to ten large scale regional centers.

Overall, the process of computerization has been carried out over a relatively short period of time (about six years), and the transition has been relatively smooth. There have of course arisen certain sources of **resistance and** tension, **especially** on the human resources side. The problems on the one hand have stemmed from **salary** levels which are substantially lower **than comparable** private levels, and on the other to the resistance to altering established manual procedures, and to the management of manpower rendered redundant by automation. It is notable **that** virtually no recourse has been taken to privatization of information services, as in the case of Mexico, a procedure which would have alleviated many of these problems.

5. MANPOWER

The growth in manpower from approximately 11,500 during the period 1978-83 to the current level of approximately 26,250 employees, has been noted above. Tables 4 and 5 below provide a breakdown of current personnel by different criteria.

The most notable feature in contrast with Mexico or Peru, and similar to India, is that the large majority of employees are civil servants. members of the same service running across **all** government departments. This implies a certain degree of uniformity and consequent rigidity in salary and discipline norms, a certain **bureaucratized culture**, and also a certain professional code. **There** are five hierarchical categories within the service, which **correspond** to **the** following: tax inspectors (category A), sub-inspectors (category B), tax agents (category C), secretaries and personnel services (category D), and manual employees such as peons (category

E).¹⁶ Entrance to these categories are through public examinations, and there is some but

TABLE 4: MANPOWER STRENGTH, APRIL 1994

	Central offices	Regional offices	Total
Civil servants	1854	16828	18682
Manual workers	622	6954	7576
Total	2476	23782	26258

TABLE 5: MANPOWER ALLOCATION, APRIL 1994

	Civil service employees by category	All employees by functional area	
		Tax assessment	5993
		Inspection	4381
A	1695	information services	2849
B	5050	Collection	3791
C	4964	Customs	2610
D	6826	General secretariat	3839
E	147	Customs vigilance	1781
Total	18682	General	1014
		Total	26258
Source: Tables 4 and 5: Resumen de Efectivos de la Agencia Tributaria, Departamento de Recursos Humanos, April 1, 1994, Agencia Tributaria.			

¹⁶There is a rough correspondence of these categories to the Indian system: category A correlates with Assistant Commissioner and Group A ITO (usually direct recruits), category B with Group B ITOs (usually promotees), Category C with tax inspectors, Category D to secretaries, and category E to peons.

not much mobility across the different levels. Those successful in the examinations are sent for training at the institute for Fiscal Studies, and thereafter absorbed in the administration.

It is important to note that top officials of the tax administration have always been promoted from within the revenue **service** cadre, rather than being appointed from **outside** groups such as economists or lawyers. This is another important point of contrast with Mexico. Moreover, there appears to be a greater emphasis, on proper legal and bureaucratic procedure **within the organization, rather than economic norms of resource allocation.**

There is also relatively little rotation of tasks amongst different employees. Transfers **across regions are based on preferences and achieved merit; there is no mandatory transfer policy** as in India. Consequently, an official in good standing wishing to stay in one office can do so indefinitely.

A fraction of gross salaries (approximately one sixth at the central level) are based on performance evaluations. These performance evaluations are conducted- by **hierarchical** superiors. The criteria used to evaluate auditors at the regional level include the 'number of **audits**, the amount of additional revenues collected, and a subjective evaluation of 'quality of work'. Prior to 1978, tax inspectors were entitled to keep 10% of all additional revenues they collected, but this system was withdrawn thereafter on the grounds of being 'unfair*. The current dependence on revenue collections is as follows. The total amount of bonus for a fixed region is decided each year. This is subsequently allocated across different inspectors, depending on the relative magnitudes by which revenue collections exceed a certain threshold. Nevertheless, these incentive components appeared to play a less important role in the motivation of inspectors, than for instance in the case of Mexico.

Inspectors have some degree of discretion over the selection and conduct of audits (this is described more fully in the following section). Considering all of the above factors -- that salary levels are considerably below those in comparable private sector positions, the low importance assigned to incentive pay based on revenue collections, the absence of mandatory transfers, and the considerable discretion allowed to auditors --- it is somewhat surprising that there is little mention of corruption among auditors. Most of those interviewed felt there was little or no corruption within the administration; in recent memory there was only one case of an auditor being sought to be dismissed on charges of attempting to over-extract revenues from taxpayers. It is possible **this** has something **to** do with the degree of professionalization of the revenue service, and the fact that the salary levels are considered 'decent', despite being lower than in the private sector. Moreover, the relative newness of the tax system perhaps implies that sufficient time has not elapsed for institutionalized corruption to set in. Or perhaps cases of **corruption have** simply **failed** to **come to light.**

6. AUDITING

There are two kinds of audits: *controles masivos*, which correspond to surface audits (or summary assessment in India), involving cross-checking of information between those contained in the taxpayer's return, and those disclosed by other parties the taxpayer has transacted with, besides checking for arithmetical mistakes and for **deductions** claimed which are prima facie inadmissible. A sample of returns are subjected to these checks, which are largely carried out by **the computerized** information system, though it is anticipated that soon all filed returns will be checked. In 1992-93, 472,663 of these checks yielded additional revenues, and 175,008 yielded revenues that were pending (i.e., yet to be collected), whilst 127,443 returns yielded no additional returns." The total additional revenues **realized** amounted to 22.81 million pesetas. These data suggest that a large number of returns do yield additional revenues, though the total order of revenues realized is small relative to total revenues collected (12,459 **billion** pesetas). Moreover, a fairly small number of returns are checked (of the order of about 6-7%). Considering that most of these checks are computerized, and therefore incur a low marginal cost, it would appear to be sensible to expand the set of returns checked.

The other kind of audits, called *profundo controles*, are the more conventional kind of detailed audits. **Individual** persons called for audit **are** asked to report to **the local tax office** with documents supporting their claimed returns, while companies are visited by tax inspectors for audits. The method of selection of taxpayers is based **mostly on** a set of criteria identified by the central office on the basis of which taxpayers are required to be selected at the provincial and regional offices. **The** latter can also augment the set identified on the basis of the centrally **determined criteria** with certain additional selections of their own. Most audits are conducted at the provincial, and to a lesser extent at the regional level (see Table 6). The returns on audits conducted at higher levels are **substantially** higher, perhaps reflecting the fact that high level audits are concentrated on large taxpayers in special sectors.

Apart from handing down the set of criteria for selection of **auditees** to local levels, the center also lays down targets in terms of the number of audits to be carried out, and of revenues to be **realized** therefrom. Each team consisting of one inspector and three deputy inspectors therefore ends up with these targets. Based on the statistics for the number of inspectors and deputy inspectors (in Table 1), and the number of audits conducted in 1992, approximately 90 audits are conducted per year by each such team, amounting to slightly above 20 audits per year per auditor. However, this may be an underestimate, as all inspectors and subinspectors may not be involved in audit activities. Indeed, in 1992 there were 450 inspectors and 1441 subinspectors allocated to the Unidades de **Inspeccion** (compared with the 789 inspectors and 1822 **subinspectors** in **AEAT** overall), and the total number of audits across all taxes in 1992 were 56,311. This suggests an average of 125 audits per **team** per year, or more than 30 audits per auditor-year. Hence the number of audits conducted is somewhat close to the corresponding

¹⁷**Source:** Memoria, Agencia **Tributaria**, 1993, Section 4.1.

figure in Mexico, and substantially below the figure for India. Assuming 240 working days, it suggests that each audit takes between eight and twelve person-days (in contrast to one in India).

TABLE 6: AUDIT STATISTICS, 1993

Office level	Total number of audits	Number of ACTAS	Additional revenues (million pst)	Additional revenues* (million pst)
Provincial	49,130	148,276	190.57	92.26
Regional	3,023	11,756	116.18	38.04
Central	320	1,789	96.91	8.74
Special taxpayer units	19,285	n.a.	n.a.	n.a.
Total	71,758	161,821#	403.66#	139.04 #
* Personal Income Tax revenues only. Previous column pertains to all taxes.				
# Excludes data for Special Taxpayer units.				
Source: Memoria. Agencia Tributaria. Section 4.2.				

Following the conduct of the audit, the inspector decides whether or not to issue an *acta*, which is an additional revenue demand notice. An *acta* can either be signed by the taxpayer (signalling his compliance with the demand), or not (signalling disagreement). A taxpayer may be issued a number of *actas*, depending on the number of violations **claimed**. An *acta* which is *not signed* by the taxpayer is *sent* to a technical **office** which then reviews the case and a fresh assessment is made by this office, which is sent back to the taxpayer. This office thus serves as the first round of appeal. If **the taxpayer** disagrees with the **revised assessment**, then the **case** proceeds to court. Note that the original inspector has little to do with the case after issuing the original *acta*, and there is a feeling among some officials in the administration that this aspect makes the inspector **less** than fully **responsible**. In 1992, a small fraction (3.9%) of *actas* were **disconfirmed**, but these accounted for 32.04% of the additional payments demanded by the inspectors. This suggests that the *actas* involving large additional demands are **frequently appealed** by taxpayers **successfully**.¹⁸

¹⁸The source for this and the remaining data in this section, is Memoria de Actividades, Agencia Tributaria, 1992, pp. 86-94.

A number of other statistics are available for the returns from audit activities for 1992 for personal income taxes (IRPF). There were 33,389 audits, resulting in 55.619 *actas*, and an additional revenue yield of 68.025 million *pesetas*, implying a yield of 2.04 million *pesetas* (of the order of US\$15,000) per audit. The returns therefore seem quite high, though it is difficult to ascertain whether this is due to high levels of evasion or to effective audits. The returns to audit activity also appear to fluctuate markedly across time: for all taxes combined, the extent of concealment discovered increased 23% in 1990 relative to 1987, and subsequently decreased to 74% and 78% in 1991 and 1992.

TABLE 7: EVASION AND AUDIT ALLOCATION BY SECTORS, 1992

	Number of audits	% of income concealed	% of taxes underpaid
ENTREPRENEURIAL			
Agriculture etc	1007	14.3	45.6
Fabrication	2481		
Construction	11089	20.3	118.4
Commercial	5237		
Minor		26.8	80.9
Major		7.5	22.5
Services	8768		
Restaurants		33.2	105.9
Transport		33.1	92.7
Repair		16.7	64.6
PROFESSIONALS			
Doctors	82	7.4	22.9
Lawyers	20	14.9	17.2
Other	47	31	29.1
OTHERS	27580		
TOTAL	56311	16.1	67.7
Source: Memoria de Actividades, 1992, Agencia Tributaria.			

Table 7 provides information on the extent of concealment of taxable base and taxes underpaid by taxpayers in different categories (all taxes combined). It turned out that the highest degrees of evasion were in the area of personal income taxes (68.6% of base concealed, and

93.9% underpayment, compared corresponding figures of 34.7% and 53.0% for company taxes, and 7.3 % and 46.8 % for the value added tax).

It appears that the highest degrees of evasion were discovered in construction, restaurant **and** transport services, and these areas also received the greatest emphasis in the allocation of audits. Moreover, the number of audits and amount of evasion discovered for **professionals** is surprisingly low, and it is difficult to infer whether this is because the true level of evasion is low, or whether it reflects insufficient emphasis on this sector.

7. APPEALS, PENALTIES AND PROSECUTIONS

Prior to 1978, there were no penalties established by law, and therefore no need to have an appeals procedure either. Following 1978, these were gradually introduced, and the legal **procedure was established only in 1985. As it stands now, the procedure operates as follows.**

The appeals procedure consists of two stages: administrative and judicial, which are sequential (in general). Moreover, each tax case is subject to at least two decisions (**i.e.**, first and second instance) at each stage of the procedure. At the administrative stage, the taxpayer can contest the **acta** either by seeking a reconsideration by the inspector who signed the **acta**, or to an administrative tribunal. The complaint must be lodged **within** 15 days after receiving the **acta**, and in the case of a reconsideration request, a definite resolution must be produced within 8 working days after the application is tiled. Administrative tribunals are also subject to time limits on their decisions. Taxpayers may be represented by tax advisors at the administrative appeals stage, and by lawyers at the judicial appeals stage. Tax appeals do not suspend the payment of tax liability, fines or interest surcharges, though such suspensions may be granted provided the taxpayer provides a guarantee of payment. There is no scope for either the tax department or the taxpayer to bear the legal costs of the other party upon losing the case.

Compared to 'the Indian system, there are therefore two rather than three stages of appeals, **ex parte** hearings are possible, and decisions are subject to time limits. Therefore, the appeals **procedure** probably works with far greater speed than does the Indian procedure. Moreover, it does not provide excessive incentives for taxpayers to file appeals simply in order **to postpone the payment of tax liability.**

Infringements are classified **into** minor and major categories; the latter include evasion via non-payment of tax liability or of amounts withheld, and illegal use of tax benefits, exemptions, refunds to which the taxpayer is not entitled. These infringements may be penalized by **both** a fine and other penalties {such as disqualification from public office for one year or from public **contracts for five years**), **as well as imprisonment in the case of criminal cases.** Cases involving evasion **of** 5 million **pesetas** or more a year (per tax), or unlawfully benefiting from tax privileges to the value of 2.5 **million** pesetas or more, are classified as cases involving

criminal tax fraud. Penalty rates range from 50% to **300%** of the amount of fraud (when assessed by the inspector), with the rate **commonly** being in the vicinity of 50%. When the penalty is assessed by the courts, it commonly ranges between **100%** to 600% of the amount of fraud. Despite this disincentive, a large majority of appeal cases are contested by taxpayers in the courts. **Finally**, imprisonment of terms varying between 6 months and 6 years can be imposed by the courts, but in practice this has almost never been used: in the last ten years only one taxpayer has been imprisoned.

There is a general sense within the tax administration and Spanish society at large that the degree of tax fraud is extensive; this is upheld by the data on evasion presented in **the** previous section. Despite this, the scale of prosecution activity has been rather low, as attested by Table 8. If attention is focused on personal income tax infringements, then the numbers are even lower. In 1993 the amount of fraud charged on prosecution cases was only 1.21 million **pesetas** (and only 35 cases initiated that year). The bulk of prosecution activity was directed at companies and VAT infringements. In this respect, therefore, the performance **of** the Spanish tax administration has been far from impressive. The reasons for this could be some combination of the following factors:

TABLE 8: PROSECUTION ACTIVITY

	Number of taxpayers affected	Number of cases initiated	Amount of fraud charged (million ptas)	Number of convictions	Number of acquittals
1989	58	131	5.99	2	5
1990	55	90	1.73	15	3
1991	28	72	3.05	21	7
1992	52	121	8.78	20	12
1993	132	197	7.59	32	7
Source: Memoria 1993. Agencia Tributaria .					

(i) The decision on whether or not to initiate prosecution in a given case is made by the tax *inspector* in question, in consultation with his immediate boss. Following a recommendation **from** the inspector, the opinion of the Legal Services department is sought. The process thus manages to grant considerable discretion to local tax inspectors in this respect as well as in the **selection** and conduct of audits.

(ii) The burden of proof has usually been cast by the courts on the tax administration, with the result that it has been very difficult for the administration to win cases going to the

courts. This is partly owing to judges taking a lenient view of tax fraud, and (probably) **to the** exercise of political influence, **especially** concerning important financial institutions and **their** top officials.

The 1990 Report on the Reform of Personal **Income** and Net Worth Taxes of the Finance Ministry also expressed its frustration with respect to the ineffectiveness and delays in the judicial system for combating tax **crime:**

"The roots of this situation should be searched for among the complex circumstances which the Judicial Administration in Spain is currently encountering and among the **difficulties** associated with assimilating tax evasion within the regular **penal** sphere as was **already** carried out with respect to **general** 'while collar crime'. The concern with **the delays in the legal** proceedings related to tax evasion **should** not, however, be mitigated. **How much longer will it take to resolve more than 400 legal** proceedings many of **which** have been pending without any diligence having been **produced** since their presentation? **Is there any sense in wanting** that the penal sanction ***provides** the required disincentive if the courts delay their **tentative** verdict more than 5 years and their definitive decision more than **10 years?** **Moreover,** it seems as if that **at** this time the option of tax evasion offers, for the most serious cases, a route of **impunity** more effective **than** its sanction through the administrative route. " (Chapter 10, p. 166)

it went **on to stress** the **need to resolve** the situation by bringing in more cases within the **ambit** of sanctions imposed by the tax administration itself, away from the judicial system.

Indeed, one of the objectives of the **creation** of **AEAT** in 1992 was to strengthen the **area** of legal actions, **and** a glance at Table 6 suggests that prosecution activity has increased significantly since 1992. The sensationalized cases of corruption **concerning** high level government officials surfacing in 1993 **and 1994 have** involved prosecution for tax fraud. **There** is a sense within the tax administration that **both social as well as** judicial attitudes **towards tax fraud** are hardening, **especially** with growing consciousness regarding high level *corruption in* the last two years. In particular, a number of cases due **to be settled soon are expected to deliver** landmark judgments likely to set a new (hard-line) precedent as far as the courts are **concerned.**

8. CONCLUDING PERSPECTIVE

The Spanish experience provides an interesting case of a **high income country that** embarked **on a programme of large** scale expansion and **modernization** of the income tax system since 1978, a relatively short **span** of time. The initial years of expansion **of the system** without concomitant administrative changes gave rise to **difficulties** in **implementing** the system **successfully.** This **problem** gave rise to a period of large scale reorganization **and** computerization of the tax administration starting 1984, which **culminated after** eight years with

the creation of an autonomous entity (**AEAT**) for tax administration, and the employment of a sophisticated information system. The workload problem was met largely by the computerization and automation of routine tasks, and only to a limited extent by an expansion in manpower employed. The system appears to be cost-effective by international standards. The most salient feature of the entire experience of obvious **value** to developing countries is the feasibility of modernizing and computerizing the tax administration system within a period of six to seven years, with **relatively** little tension, provided the **political will** exists.

Also interesting is the absence of reliance **on** privatization of major operations, or the use of modern market-like incentive methods within the administration. The modernization process has taken place within a traditional framework of a civil service bureaucracy organized in the form of a vertical hierarchy. On the one hand, it demonstrates how modernization can be achieved without major recourse to market-based methods. On the other hand, it is clear that this has imposed restrictions on the flexibility and efficiency of the organization, to which the government has responded by allowing gradual increases in autonomy.

One unique feature of the Spanish tax administration, in contrast with most developing countries, is the seeming absence of corruption within the organization. This is particularly given the high levels of corruption outside, as manifested in the high levels of tax evasion by taxpayers, and levels of political corruption. This partly explains the relatively little emphasis on reform of policies concerning motivation of personnel.

The main weakness of **the** administration has been in the area of initiating prosecution of suspected evaders, though may have been partly caused by the lenient pro-taxpayer attitudes **held** by the courts. **However, this appears** to be changing since 1992, as **manifested** by increases in prosecution intensity, the emphasis on strengthening legal services within the newly created **AEAT**, and the changing attitudes of the courts.

The changes most urgently required in the coming years, besides (ii) penalty and prosecution activity, lies in (ii) manpower policies, including policies of job rotation, incentive pay, decreasing auditor discretion, and in (iii) increased autonomy and **flexibility** in the organization over the setting of salary levels, budgets and procurement operations. Indeed, the areas of administrative reform which have been emphasized in the 1990 Report on the Reform of Personal Income and Net **Wealth** Taxes of the Economy and Finance Ministry are personnel management, budgetary resources, and the tight against tax crime.

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